

1st Quarter 2015 Commentary
Declining Earnings In An Expensive World

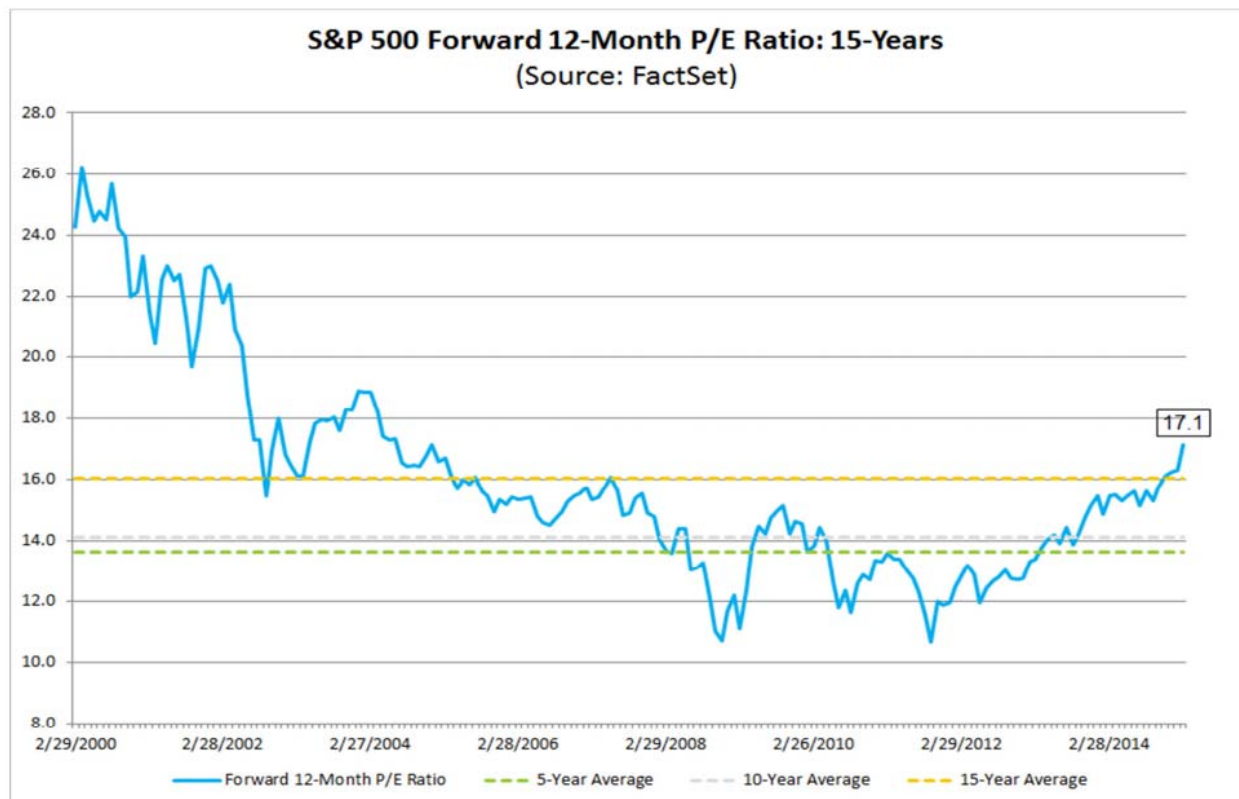
Despite a bit of volatility, the first quarter finished very close to where it started the year. The Dow posted a slight loss while the S&P 500 recorded a small gain.

Dow Jones Industrial Average

Real Time Quote | Source: Exchange



More importantly, the forward looking Price to Earnings ratio for the S&P 500 index is approximately 17.1 according to FactSet. As the graphic below illustrates, the stock market has not been valued this highly in ten years.



What is interesting about this is that the Price to Earnings ratio is increasing not because the “Price” part of the index is going up, but rather because earnings are declining.

According to S&P Capital IQ, first quarter earnings have declined 3% on a year-over-year comparison. If true, the S&P 500 may post their first year-over-year decline since the third quarter of 2012 and the worst quarterly decline since 2009.

Much of the drop can be attributed to the precipitous fall in oil prices (down 63%) and the effect of the strong dollar on multi-national companies.

WTI Crude Oil (May'15) (@CL.1 :New York Mercantile Exchange)

* Data is delayed

47.72 USD

▲0.12 (+0.25%)

632



The U.S. Dollar is up 9% for the year, which continues to have a negative effect upon companies who sell product outside the U.S.

Across the board, sales, profit margins and earnings trends are all negative.

U.S. 10 Year Treasury

* Data is delayed

1.9266%

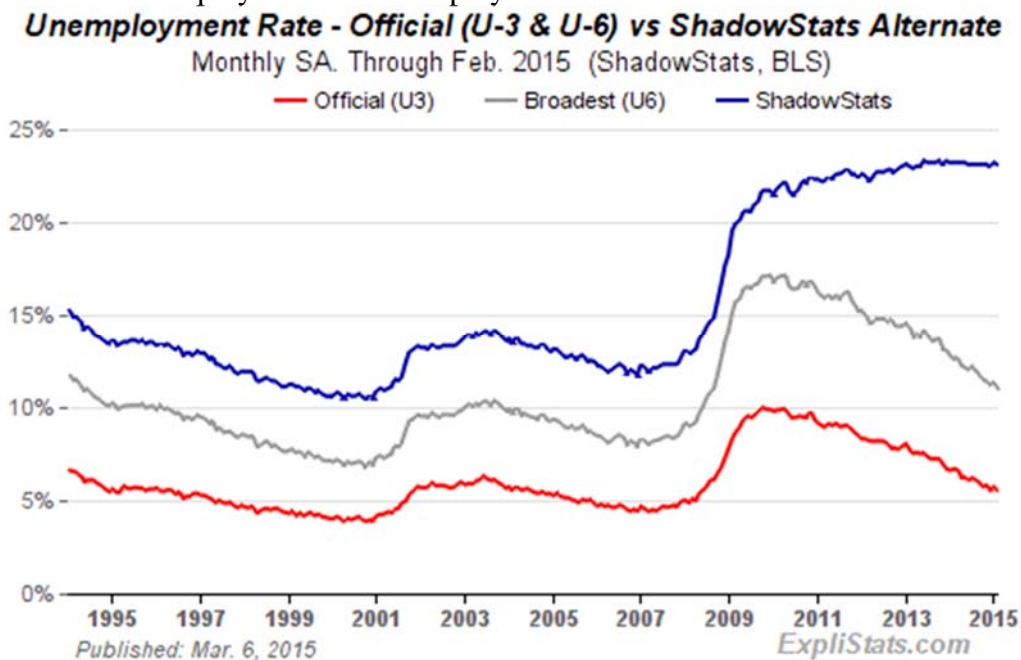


The Federal Reserve has started to give indications they will increase interest rates sometime in 2015. From what we see, the economy is too weak to raise rates in a meaningful manner. As such, it would not surprise us to see a ¼ point increase in the second half of the year—but that’s about it.

Despite the telegraphing of this move by the Fed, the fixed income markets have reacted by shoving rates back down. If you lend money to the US Treasury for the next 10 years they will pay you a whopping 1.93%--before taxes!

Although the “official” unemployment rate stands a bit above 5%, gamesmanship with that calculation masks a more difficult situation.

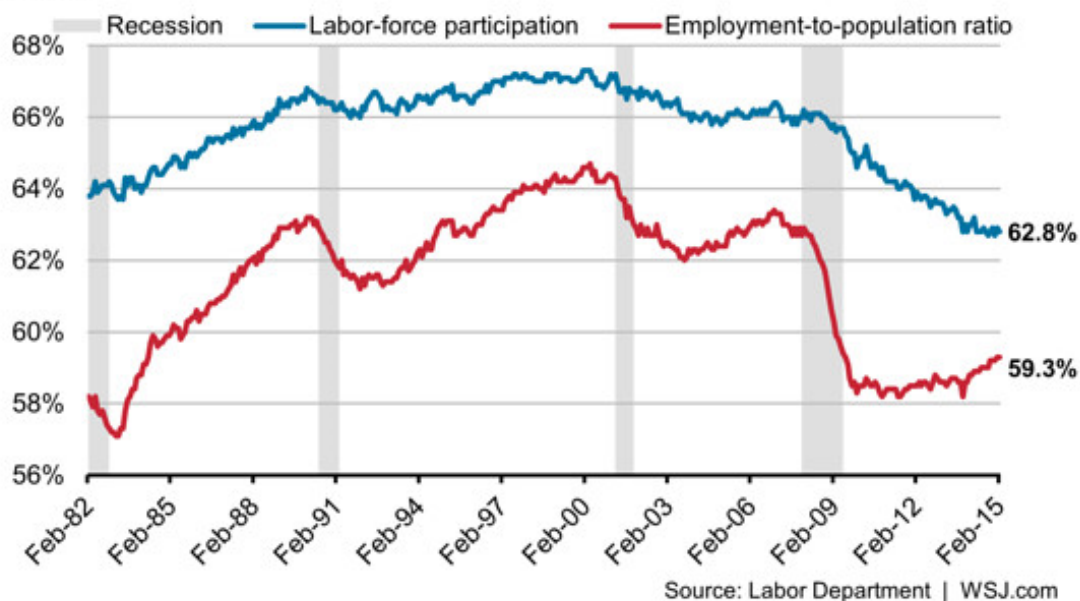
Once you add in those who are under-employed, have quit looking for a job or those whose unemployment benefits have run out, the true rate of unemployment/under-employment is about 23%.



If the unemployed/under-employed statistic does not get the point across, then the Labor-Force Participation Rate should. It shows that the number of people actually working stands at its lowest levels in 36 years.

Labor-Force Participation Near 36-Year Low

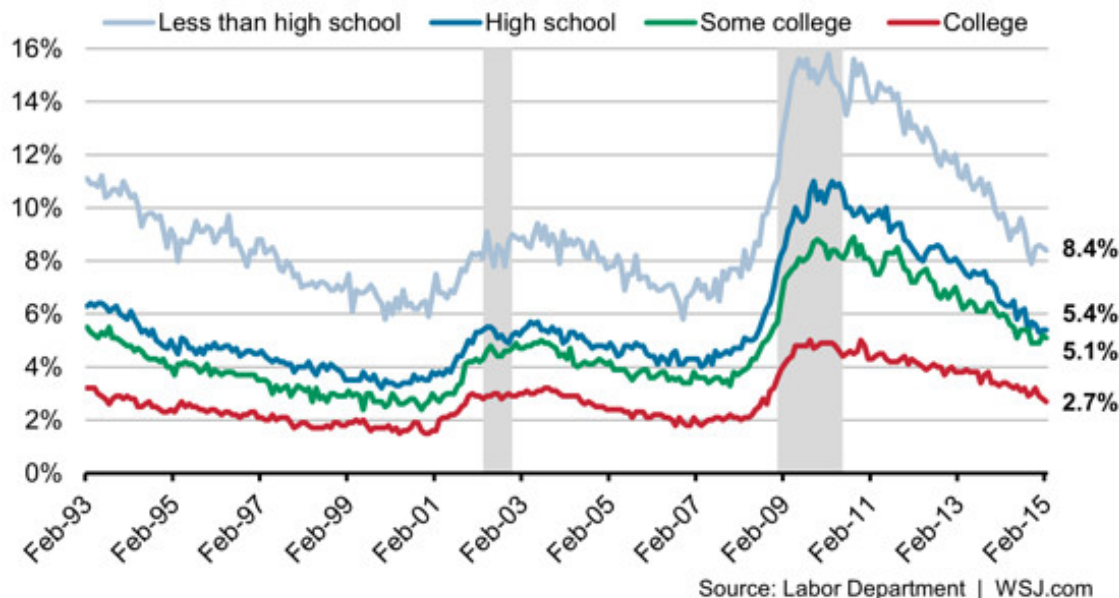
Share of civilians in the U.S. labor force and employment-to-population ratio, seasonally adjusted



Furthermore, we state the fairly obvious: those with an education have the most employable skillset.

Unemployment by Education

Unemployment rate for civilians 25 years and over by educational attainment, seasonally adjusted



Despite a rather gloomy outlook of sluggish economic growth, poor labor participation and expensive stock market valuations, **we remain cautious, but positive.**

Several holdings have been liquidated recently either because they were taken over at significant premiums, or we were able to sell assets trading well above historical norms.

This has boosted cash levels. And although cash may not pay much in terms of interest, it does give us tremendous flexibility.

Amazingly, despite the earnings declines, we have been surprised to find very high quality companies that have been “thrown out with the bath water.” As such, we are happy to redeploy cash into assets that should produce solid returns over the next ten-plus years.

Lastly, we hope you will put Thursday April 23rd on your calendar as we will celebrate our 16th anniversary.

Since we have no reason for existing if not for truly incredible clients, we hope you’ll join us for a bite to eat and something cold to drink.

As is tradition, the festivities will be at Fossati’s (302 S. Main in Victoria) from 5pm to 8pm. We hope to see you there!

Sincerely,

Dave

Dave Sather
CERTIFIED FINANCIAL PLANNER™

Warren

Warren Udd
CERTIFIED FINANCIAL PLANNER™